



**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 525
LOS ANGELES, CALIFORNIA 90012-3873
PHONE: (213) 974-8301 FAX: (213) 626-5427

WENDY L. WATANABE
AUDITOR-CONTROLLER

February 3, 2014

TO: Mitchell H. Katz, M.D., Director
Department of Health Services

FROM: Wendy L. Watanabe
Auditor-Controller

A handwritten signature in blue ink that reads "Wendy L. Watanabe". The signature is written in a cursive, flowing style.

SUBJECT: **DEPARTMENT OF HEALTH SERVICES - CENTRAL PHARMACY
PROCUREMENT REVIEW**

We reviewed the Department of Health Services' (DHS or Department) Central Pharmacy's (Pharmacy) compliance with County procurement policies and procedures for purchasing and controlling pharmaceuticals and related supplies. Our review included interviewing Pharmacy personnel, reviewing purchases, evaluating internal controls, inventorying equipment and supplies, and observing Pharmacy supply operations at all DHS facilities.

As of the issuance of this report, the Pharmacy has not implemented the County's electronic Countywide Accounting and Purchasing System (eCAPS) Procurement function. DHS Pharmacy believes the system has extensive limitations, and is not designed to handle the pharmaceutical procurement processes required by the Department.

Background

The Pharmacy is responsible for ordering pharmaceuticals and related supplies, receiving deliveries, shipping supplies to health centers, tracking Pharmacy supply inventories, processing prescriptions, and disposing of expired pharmaceutical items. At the time of our review, the Pharmacy had 25 dispensaries at 14 DHS facilities that maintained pharmaceuticals and supplies for patients. As of June 30, 2011, the inventory for all locations totaled approximately \$11.6 million.

Review Summary

We noted that the Pharmacy's purchases were generally appropriate and necessary for pharmaceutical operations at the DHS facilities. However, Pharmacy management needs to ensure that staff comply with all purchasing requirements, inventory records are accurate, and noted discrepancies are properly investigated. The following are the detailed results of our review.

General Purchasing and Payment Controls

County Fiscal Manual (CFM) Chapter 4 requires department staff to complete purchase requisitions to request items and to obtain management approval. Approved requisitions are sent to procurement staff, who subsequently issue purchase orders to vendors to order the requisitioned items. Purchase orders are to be matched with invoices and receiving reports prior to issuing payments to vendors to ensure correct pricing, quantities delivered, and that the goods were in fact requested. CFM Section 4.5.2 also requires invoices to be marked "paid" to ensure that duplicate payments are not made.

We reviewed 44 purchases made by the Pharmacy, totaling approximately \$1.8 million, and noted:

- **Purchase Requisitions Not Supported by an Approved Requisition** - Each facility initiates orders directly on the vendor's website, and the Pharmacy's buyers are electronically notified of the order. The buyers verify that pricing and order quantities are reasonable, make any necessary changes, and complete the online order. Facilities also call or fax orders directly to the Pharmacy. However, the facilities do not always complete a requisition to document that a request was reviewed/approved, as required by County purchasing guidelines. Specifically, we noted 25 (57%) of the 44 purchases reviewed were not supported by an approved requisition. Requisitions document that the items to be ordered are approved by a person with the appropriate decision-making authority.
- **Invoices Not Marked "Paid"** - The Pharmacy did not mark 32 (73%) invoices reviewed "paid". While none of the invoices were paid twice, the Pharmacy should mark invoices "paid" to prevent duplicate payments.

Recommendations

Pharmacy management:

1. **Ensure requisitions are completed, approved, and retained for all purchases.**
2. **Mark invoices "paid" to prevent duplicate payments.**

Non-Agreement Purchases

The Internal Services Department (ISD), as the County's purchasing agent, delegated DHS the authority to purchase non-agreement items under \$5,000. All purchases over the delegated authority must be processed by ISD. Departments must comply with ISD policies when making non-agreement purchases within their delegated authority, including obtaining three price quotes for purchases over \$1,500. Purchases may not be split to circumvent the limit of DHS' delegated authority.

We reviewed 20 of the Pharmacy's non-agreement purchases, and noted DHS:

- **Did Not Obtain Price Quotes** - The Pharmacy did not obtain the required price quotes for four (20%) non-agreement purchases reviewed between \$1,500 and \$5,000, totaling \$17,100.
- **Made Purchases Exceeding Delegated Authority** - The Pharmacy made four (20%) purchases over \$5,000, totaling \$37,800, which exceeded their delegated authority. These purchases should have been processed by ISD.
- **Split Purchases** - We reviewed 37 potential split purchases, and identified nine (24%) purchases, totaling \$68,600, that were split to stay within the Pharmacy's delegated authority. Each of the purchases within the split pairs of like-purchases were consecutively made by the same respective buyers and to the same vendors.

Recommendations

Pharmacy management:

3. **Obtain price quotes for non-agreement purchases, as required by County purchasing policies.**
4. **Ensure purchases exceeding the delegated authority are processed by the Internal Services Department, and are not split to circumvent purchasing limits.**

Pharmacy's Perpetual Inventory Records Were Not Accurate

At the time of our review, the Pharmacy had 25 dispensaries at 14 DHS facilities that maintained pharmaceuticals and supplies for patients. We noted that 19 of the 25 dispensaries maintained perpetual inventory records using the Pharmacy Stock Control Audit System (PSCAS), five dispensaries used the Pharmacy Inventory Management System (PIMS), and the remaining dispensary used a manual system.

Our review noted that the Pharmacy's perpetual inventory records were not accurate. We conducted an inventory at five of the Pharmacy facilities and noted the following:

- **Physical Inventory Count Does Not Match Perpetual Inventory Records** - The physical count for 29 (58%) of the 50 items inventoried, totaling \$301,400, did not match the Pharmacy's perpetual inventory records.
- **Inventory Shortages and Overages** - Our review identified shortages and overages totaling \$58,100 and \$29,100, respectively. For example, at one facility the inventory system showed 1,400 diphtheria-tetanus syringes on hand. However, we were only able to account for 120 syringes, a \$23,800 shortage.

Pharmacy management indicated that they were aware the perpetual inventory records were not accurate, and that the primary reason for the discrepancies is that staff sometimes input the wrong quantities when entering the amount received into the inventory system. The Pharmacy completes physical inventory counts and adjusts the perpetual inventory records to agree with the physical counts, but does not investigate discrepancies. CFM Section 5.3.2 requires departments to investigate any significant differences and report the results to management. Pharmacy management should investigate discrepancies between physical inventory counts and perpetual records to prevent losses or thefts from going undetected.

Recommendation

5. **Pharmacy management investigate discrepancies between physical inventory counts and perpetual inventory records.**

Expired Items

When pharmaceuticals expire, they can be returned to the manufacturer for disposal, and in some cases, a credit. The Pharmacy uses a disposal company to collect expired pharmaceuticals from each facility and return them to the manufacturers. At the time of pick-up, the disposal company gives the facility a list of the items collected and an estimated value. However, the facilities do not verify that all the items picked-up are included on the list. Therefore, they cannot determine if they received the proper credit. The Pharmacy should ensure that facilities verify that all pharmaceuticals collected for disposal are included on the disposal company's list and that credits are accurate.

Recommendation

6. **Pharmacy management verify that all pharmaceuticals collected for disposal are included on the disposal company's list and that credits are accurate.**

Internal Control Certification Program

The Auditor-Controller developed the Internal Control Certification Program (ICCP) to assist County departments in evaluating and improving internal controls over fiscal operations. Departments are required to review their controls in key areas and certify that proper controls are in place, or that action is being taken to correct any deficiencies or weaknesses noted.

At the time of our review, the Pharmacy did not complete biennial ICCPs. Pharmacy management indicated that they were not aware of the ICCP requirement. In addition, the Pharmacy was not included in DHS' list of assessable units for Health Services Administration or any of the facilities. As a result, the Pharmacy's internal controls have not been evaluated. Most of the issues noted in this report would have been identified if the Pharmacy properly completed its ICCP. Pharmacy management should ensure that the ICCP is completed biennially.

Recommendation

- 7. Pharmacy management ensure the Internal Control Certification Program is completed biennially.**

Review of Report

We discussed the results of our review with Pharmacy management. They generally agreed with our findings and recommendations, and indicated that they will work to improve controls over their Pharmacy procurement practices. DHS' attached response describes the corrective actions they have taken, or plan to take, to address the recommendations in our report.

We thank Pharmacy management and staff for their cooperation and assistance during our review. Please call me if you have any questions, or your staff may contact Robert Smythe at (213) 253-0101.

WLW:AB:RS

Attachment

- c: William T Fujioka, Chief Executive Officer
Jim Jones, Director, Internal Services Department
Department of Health Services
Amy Gutierrez, Pharmacy Director
Anish Mahajan, M.D., Director, System Planning Improvement & Data Analytics
Tobi L. Moree, Chief, Audit & Compliance Division
Audit Committee



January 30, 2014

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TO: Wendy L. Watanabe
Auditor-Controller

FROM: Mitchell H. Katz, M.D. *Mitchell Katz*
Audit and Compliance Division

SUBJECT: **RESPONSE TO AUDITOR-CONTROLLER'S
CENTRAL PHARMACY PROCUREMENT REVIEW**

Mitchell H. Katz, M.D.
Director

Hal F. Yee, Jr., M.D., Ph.D.
Chief Medical Officer

Christina R. Ghaly, M.D.
Deputy Director, Strategic Planning

Attached is the Department of Health Services' response to the recommendations made in the Auditor-Controller's report of its review of the Central Pharmacy Procurement System. We have taken or initiated corrective actions to address the recommendations contained in the report.

If you have any questions or require additional information, please let me know or you may contact Tobi L. Moree at (213) 240-7901 or Elizabeth Guzman at (213) 240-7759.

313 N. Figueroa Street, Suite 912
Los Angeles, CA 90012

Tel: (213) 240-8101
Fax: (213) 481-0503

www.dhs.lacounty.gov

MHK:tlm:eg

Attachment

c: Anish Mahajan, M.D.
Amy Gutierrez, PharmD
Tobi L. Moree

*To ensure access to high-quality,
patient-centered, cost-effective
health care to Los Angeles County
residents through direct services at
DHS facilities and through
collaboration with community and
university partners.*



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COUNTY OF LOS ANGELES - DEPARTMENT OF HEALTH SERVICES
RESPONSE TO AUDITOR - CONTROLLER PROCUREMENT REVIEW
CENTRALIZED PHARMACY

This is in response to the Auditor-Controller's (A-C) review of Pharmacy Procurement. The Department's response for each recommendation is as follows:

Auditor-Controller Recommendation No. 1

Pharmacy management ensure requisitions are completed, pre-approved, and retained for all purchases.

Department of Health Services (DHS) Response:

We agree. Requisitions are automatically generated at each DHS facility pharmacy based on pre-defined PAR levels (minimal stock levels) for drug stock, set by the local pharmacy manager at each location. Non-PAR level drug requisitions are approved by the local pharmacy supervisor.

DHS Core Pharmacy and Therapeutics (P&T) Formulary Selection and Maintenance Process Policy No. 329.002 maintains the drug formulary and was revised on January 10, 2012 and January 8, 2013. The drug formulary is a continually updated list of medications and related information representing the clinical judgment of physicians, pharmacists, and other experts in the diagnosis and/or treatment of disease and health promotion. All formulary drugs ordered by each pharmacy are included on the DHS pre-approved drug formulary.

DHS Process for Outpatient Prior Authorization Medication Requests Policy No. 329.007, implemented on July 15, 2010 and revised on October 9, 2012, defines the approval process and includes the prior authorization request form which must be completed for all purchases not on the approved formulary.

DHS Pharmacy Procurement retains copies of all requisitions and submits a copy to the local facility pharmacy for their records.

Auditor-Controller Recommendation No.2

Pharmacy management mark invoices "paid" to prevent duplicate payments.

DHS Response:

We agree. Since the time of the audit, the Department is in the process of moving to a completely paperless invoice system. In the event that paper invoices are received, they would be marked "paid" to prevent duplicate

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payments. The Department has controls in place to ensure that invoices are not paid twice.

Auditor-Controller Recommendation No. 3

Pharmacy management obtain price quotes for non-agreement purchases as required by County purchasing policies.

DHS Response:

We agree. Currently, for purchases from non-agreement vendors Pharmacy management obtains three price quotes for purchases between \$1,500 to \$5,000 and works with Internal Services Department (ISD) to process purchases over \$5,000. If the pharmaceutical is sole source, a sole source justification form will be provided to ISD as part of the procurement process.

The Board of Supervisors (the Board) has approved DHS as a member organization of UHC Novation and also to access and implement UHC Novation agreements for purchases. All DHS facilities are members of UHC Novation and access multiple pricing agreements for supply chain and pharmaceutical purchases. UHC Novation negotiates the DHS pharmaceutical wholesaler agreement, which DHS utilizes for pharmaceutical purchasing. The current pharmaceutical distribution agreement with Cardinal Health is a UHC Novation agreement.

On May 14, 2008, ISD provided DHS Pharmacy management with documentation of an agreement (exception) which indicated that the centralized DHS pharmacy division is approved for purchasing drugs, that are not specifically covered on Novation pharmaceutical agreements and/or the 340B program after a market survey is conducted. Pharmacy received an extension to this agreement (exception) through April 20, 2013. Pharmacy management has been working with the understanding that this documentation allows Pharmacy management to purchase non-agreement patient pharmaceuticals with no price restrictions through Cardinal, the agreement wholesale pharmacy vendor and exempts them from the ISD requirements to obtain three price quotes for purchases between \$1,500 and \$5,000, and to work with ISD to process purchases over \$5,000, for non-agreement patient pharmaceuticals purchased from the Pharmacy agreement vendor. All non-formulary pharmaceuticals are subject to three layers of review: (1) onsite pharmacy manager, (2) DHS central pharmacist and (3) facility medical director or designee, prior to purchase. Some of these agents are needed for hospitalized patients or others who may require life-saving treatment in an urgent manner.

Pharmacy management is currently working to extend, clarify and document this exception with ISD, given the critical timelines involved for providing pharmaceuticals in urgent patient care situations.

Auditor-Controller Recommendation No. 4

Pharmacy management ensures that purchases exceeding delegated authority are processed by ISD, and are not split to circumvent purchasing limits.

DHS Draft Revised Response Jan. 24, 2014:

We partially agree. Currently, when pharmaceutical purchases exceed the delegated authority of \$5,000 and are not made through the agreement vendor, ISD is notified by e-mail. Price quotes and sole source justification are provided to ISD as necessary and purchases are not split to circumvent purchasing limits. Due to the emergent need of non-agreement pharmaceuticals purchased for patients, and ISD response time, medications are purchased concurrent with an e-mail to ISD.

On May 14, 2008, ISD provided DHS Pharmacy management with documentation of an agreement (exception) which indicated that the centralized DHS pharmacy division is approved for purchasing drugs, that are not specifically covered on Novation pharmaceutical agreements and/or the 340B program after a market survey is conducted. Pharmacy received an extension to this agreement (exception) through April 20, 2013. Pharmacy management has been working with the understanding that this documentation allows Pharmacy management to purchase non-agreement patient pharmaceuticals with no price restrictions through Cardinal, the agreement wholesale pharmacy vendor and exempts them from the ISD requirements to obtain three price quotes for purchases between \$1,500 and \$5,000, and to work with ISD to process purchases over \$5,000, for non-agreement patient pharmaceuticals purchased from the Pharmacy agreement vendor. All non-formulary pharmaceuticals are subject to three layers of review: (1) onsite pharmacy manager, (2) DHS central pharmacist and (3) facility medical director or designee, prior to purchase. Some of these agents are needed for hospitalized patients or others who may require life-saving treatment in an urgent manner.

Pharmacy management is currently working to extend, clarify and document this exception with ISD. Based on the results of discussions with ISD, Pharmacy will either document the exception or will ensure purchases exceeding delegated authority are processed by ISD, and are not split to circumvent purchasing limits; however, as stated above, urgent medications will be purchased concurrent with an e-mail to ISD.

Auditor-Controller Recommendation No. 5

Pharmacy management investigates discrepancies between physical inventory counts and perpetual inventory records.

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DHS Response:

We agree. DHS Monthly Pharmaceutical Inventory Policy No. 329.008, was established July 15, 2010 due to Auditor-Controller concerns, and revised on August 22, 2012. DHS Policy No. 329.008 states facility pharmacies must take a monthly inventory of the top 25 high cost and/or high diversion risk medications. The facility must investigate and resolve all discrepancies. Any discrepancies above 20% that continue for three consecutive months must be reported to DHS Pharmacy Affairs for investigation. A complete inventory of the pharmacy is reported to DHS Fiscal Services at the end of each fiscal year.

As of May 2011, third party software, Talyst, was installed at all of the hospitals to maintain a perpetual inventory for the inpatient pharmacy areas. Hospital pharmacies within DHS contain the largest pharmaceutical inventories within DHS. In addition, a meeting was held with the Auditor Controller's office to review the security features of the Talyst inventory software.

As documented in previous Auditor Controller reports, the current outpatient pharmacy system, ISD Pharmacy Stock Control Audit System (PSCAS) lacks full ability to maintain accurate perpetual inventories for pharmaceuticals. As a result, the pharmacy conducts monthly audits of the high cost and/or high diversion risk drugs in accordance with DHS Policy No. 329.008. This is in addition to the annual pharmacy inventory obtained at the end of each fiscal year. As a result of the Board's approval of the DHS central fill pharmacy project, ISD's PSCAS software is scheduled to be replaced by the end of 2014 with a new state-of-the-art pharmacy system, Cerner Etreby, which will maintain a pharmaceutical perpetual inventory.

Auditor-Controller Recommendation No. 6

Pharmacy management verify that all pharmaceuticals collected are included on the disposal company's list and that credits are accurate.

DHS Response:

We agree. Currently, the reverse distributor vendor for pharmaceutical returns collects expired pharmaceuticals from all DHS pharmacy locations for partial credits and disposal. Prior to leaving the DHS pharmacy, the vendor provides a list of controlled substances collected to facility pharmacy management. For the non-controlled substances, a list of products and estimates is prepared at the vendor's warehouse and provided to facility pharmacy management. Credits for applicable items are provided to the facility via a pharmacy agreement vendor credit, reimbursement check or replacement product.

DHS Pharmacy Affairs has developed a DHS system pharmaceutical return policy that includes a process for reconciling returned drugs with the disposal

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company's list and with credits and/or reimbursement checks and/or replacement products received in order to verify that all pharmaceuticals collected are included on the vendor's list and that credits are accurate.

DHS Pharmacy Affairs is also working with the reverse distributor vendor to develop a plan to meet this requirement.

Auditor-Controller Recommendation No. 7

Pharmacy management ensure the Internal Control Certification Program (ICCP) is completed annually.

DHS Response:

We agree. Pharmacy management will work with DHS Finance and Facility Pharmacy staff to ensure the required ICCP sections are completed for the 2014 ICCP assignment.